

# Chile

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In order to create an attractive, dynamic and competitive business environment, over the last two decades Chile has established public policies focused on the consolidation of responsible macroeconomic management, increased international integration, the strengthening of its institutions and the promotion of economic liberalisation and the free market.

A reform of the bankruptcy legal framework became effective in 2005. Although the principles and foundations of the existing framework were preserved, the reform introduced changes aimed at increasing transparency and efficiency in the private bankruptcy administration system and improving the role of the public supervisory entity, the Superintendence of Bankruptcies.

Changes to certain formal aspects and mechanisms of the bankruptcy process and formal and informal rescue processes were also introduced. However, to date it has not been possible to assess the practical consequences of such changes, as only a few cases have been commenced under the reformed legal framework.

## **1. The legal framework and the effectiveness of court processes/legal remedies**

### ***1.1 Describe the nature and the effectiveness of the following:***

#### ***(a) Debt recovery remedies where the debtor has no security***

There are two debt collection court proceedings: accelerated debt collection and ordinary debt collection. An accelerated debt collection action is one supported by an expedient claim title. An expedient claim title is a document meeting specified formalities. In the absence of such title, an unsecured creditor must resort to an ordinary proceeding.

The accelerated debt collection proceeding is faster than normal, taking one to three years, as compared to the ordinary debt collection process, which takes three to five years.

Within a bankruptcy proceeding, unsecured creditors may be paid only after all claims enjoying statutory priority and secured creditors have been paid. Thus, in the event of bankruptcy the chances of recovery for unsecured creditors are significantly reduced.

#### ***(b) The enforcement of security***

Liens on tangible property (eg, mortgages and pledges) are enforceable through the accelerated debt collection process.

Chilean legislation does not provide alternatives to judicial enforcement and foreclosure of security. The parties may not contractually agree in a mortgage or pledge that a creditor is entitled to undertake repossession on its own behalf. The enforcement system is judicial only and (with very narrow exceptions) non-judicial enforcement methods are not legally allowed.

**(c) Corporate bankruptcy/liquidation processes**

Similar to Chapter 7 of the US Bankruptcy Code, in a bankruptcy the appointed trustee or receiver liquidates the debtor's assets and then distributes the proceeds of the liquidation among the creditors. Although realisation of the bankruptcy estate should be promptly completed in order to satisfy creditors' claims with the proceeds thereby obtained, in practice liquidation is a lengthy process. The average duration of a liquidation is between 24 and 36 months.

**(d) Formal corporate rescue processes**

The Bankruptcy Act allows the debtor and its creditors to come to a formal rescue agreement to avoid a potential bankruptcy or to halt an initiated bankruptcy. These agreements can provide for either a bankruptcy pre-emption process or a bankruptcy release process.

**(e) Informal corporate rescue procedures**

Informal corporate rescue processes depend on the negotiations undertaken between the debtor and its creditors and may be implemented only insofar as no bankruptcy has been filed. Such negotiations are formalised in out-of-court agreements, which bind only the signatory parties.

**1.2 What are the formal processes to effect a liquidation of the company's assets?**

Within a bankruptcy, the following sequence of events takes place:

- The bankruptcy petition (voluntary or involuntary) is filed.
- The court declares bankruptcy.
- The automatic stay takes effect (individual collection actions are stopped).
- Creditors of the bankruptcy are notified.
- An interim trustee or receiver is appointed.
- The debtor files schedules of assets and debts.
- The creditors hold the first meeting and confirm or elect the permanent trustee or receiver.
- Creditors file their claims for verification.
- The trustee or receiver determines which property is subject to liquidation.
- The trustee or receiver liquidates the assets included in the bankruptcy.
- The trustee or receiver distributes the proceeds of the liquidation.
- The court closes the case after two years of

approval of the trustee's final account, provided that the debtor has acted in good faith.

**1.3 What is the effect on debt collection and the enforcement of security of:****(a) An adjudication of corporate bankruptcy/liquidation?**

As soon as bankruptcy is declared, individual debt collection actions and all pending legal actions are suspended. In exceptional cases certain secured creditors may pursue individual debt collection procedures even after the bankruptcy declaration.

In particular, for mortgage or pledge creditors individual debt collection actions may continue or be commenced under certain conditions in order to liquidate the asset in question and to obtain payment from the liquidation proceeds.

**(b) The commencement of a formal corporate rescue process?**

Unless two or more creditors representing more than 50 per cent of the total claims support the debtor's submission of the bankruptcy pre-emption process proposals to initiate a formal rescue process, the rights of creditors to demand payment individually from the debtor and all pending legal actions against the debtor are not suspended.

**(c) The initiation of an informal corporate rescue process?**

Informal corporate rescue processes have no effect on debt collection and enforcement of security, except for those creditors that enter into an out-of-court agreement, in which case the extensions and remissions provided therein will be binding only on the parties to the agreement.

**1.4 Are insolvency procedures started in another jurisdiction in respect of a corporation incorporated in your jurisdiction recognised? In particular, what would be the impact of US bankruptcy proceedings being commenced?**

Under Chilean law, bankruptcy proceedings must be heard by the court of the debtor's domicile.

For Chilean legal purposes, a corporation incorporated in Chile is domiciled in Chile. Thus, the bankruptcy of a Chilean corporation may be declared and conducted only by a Chilean court.

Therefore, Chapter 11 proceedings in the

United States would have no direct impact on a Chilean corporation.

**1.5 In what circumstances would the directors or officers of a company in financial difficulties face potential liability for continuing to trade? In practice, are any such provisions actually enforced?**

The directors or officers of a company in financial difficulties may face personal and criminal liability if the bankruptcy is deemed to be negligent or fraudulent as defined in the Bankruptcy Law.

Fraudulent bankruptcy exists in certain cases – for example, where dividends have been fraudulently distributed to shareholders or property fraudulently conveyed to third parties.

**2. What are the advantages and disadvantages of triggering a formal insolvency or corporate rescue procedure?**

The advantages are as follows:

- Individual debt collection proceedings, except for those relating to certain secured creditors' claims, are terminated.
- The debtor is prevented from managing the business and its powers are passed to the receiver.
- All executions and collection actions are suspended for 90 days, including secured claims, and the stay is extended until such date as the creditors approve an agreement.
- The debtor may pass jurisdiction to an arbitral court, which is usually more flexible, expedient and well versed in insolvency matters.
- The expert facilitator, although as yet untested, presents an interesting new alternative available to the parties to facilitate the negotiation of a restructuring plan or work-out.

The disadvantages are as follows:

- The Bankruptcy Law does not provide sufficient mechanisms to facilitate a speedy liquidation of the assets or to implement a corporate rescue process.
- Even after the bankruptcy case is closed, the debtor will encounter difficulties in obtaining new credit facilities.
- The Bankruptcy Law requires the debtor's consent for all major decisions. Thus, the owners of the bygone equity of the company can effectively exercise undue leverage and influence in the process to their advantage and to the detriment of unsecured creditors.

**3. What are the practical options for out-of-court restructuring?**

Out-of-court arrangements may be entered into by the debtor and its creditors with the aim of avoiding bankruptcy. This is a viable option only where bankruptcy has not been declared. Out-of-court arrangements are forbidden afterwards and where a sufficiently meaningful portion of the claims is involved, since hold-outs will not be bound.

**4. What is the effect on the management of a company of:**

**4.1 An adjudication of corporate bankruptcy/liquidation?**

The bankruptcy adjudication has the immediate effect of handing over the administration of the bankrupt's property within the bankruptcy estate to a receiver, who is an independent third party. The receiver carries out the following duties:

- administering the property, assets and liabilities of the insolvent company;
- continuing its line of business;
- representing the company in lieu of its board;
- realising its assets; and
- paying off its creditors with the net proceeds thereof in accordance with the applicable statutory priorities.

Receivers are reasonably qualified independent court-appointed officials selected from a national list of persons appointed by the Ministry of Justice, who hold a degree in engineering, accountancy or law and have at least five years' experience.

In their conduct of a bankruptcy/liquidation, receivers are subject to the ultimate decision of the creditors acting collectively in regular or extraordinary creditors' meetings. The applicable quorums and majorities for the creditors' meeting are set out in the Bankruptcy Law and vary depending on the nature of the relevant action or decision.

**4.2 The commencement of a formal corporate rescue process?**

There are two types of formal (ie, in-court) rescue process:

- a bankruptcy pre-emption process, which is aimed at pre-empting an adjudication or a bankruptcy declaration of a debtor in default; and
- a bankruptcy release process, which is aimed at

terminating the bankruptcy proceedings and releasing the bankrupt.

In both cases a rescue process is achieved if the debtor and a special majority of its creditors approve and execute a special creditors' agreement providing for debt relief and any other lawful arrangements that the parties may devise to bring the insolvent debtor back to financial fitness and to repay the obligations covered in the relevant agreement.

In the case of the bankruptcy pre-emption process, the debtor can initiate the rescue process by filing in court an agreement proposal for the approval of its creditors. Alternatively, creditors that are entitled to petition for the adjudication of the debtor may ask the court to force the debtor to submit agreement proposals. Furthermore, the Bankruptcy Law was recently amended to include a third alternative that may lead to an agreement whereby the debtor, instead of making agreement proposals, may elect to ask the court to call for a creditors' meeting that will specifically designate an expert facilitator to be charged with submitting such agreement proposals.

In the case of the bankruptcy release process, the debtor or its creditors may submit agreement proposals at any time while such bankruptcy proceedings are in progress.

Commencing on the date of submission of the agreement proposals and until such proposals are approved or rejected, the effect on the management of the debtor is that its power and authority to represent, administrate and dispose of company property pass to the receiver. However, if the debtor elects to ask the court to call for a creditors' meeting to designate an expert facilitator, the debtor shall keep its management powers, subject to supervision by an overseer and with limited disposition powers.

In both cases the receiver (or the overseer) shall be vested with the authority to:

- access all company records, accounts and transactions;
- track all company income and expenses;
- approve all payments to creditors;
- inform the creditors on a quarterly basis about company affairs and the board's conduct of its duties;
- ask the bankruptcy court to convene creditors' meetings; and
- generally represent creditors' interests.

In all cases the approval of an agreement results in the board of the company recuperating its

management powers and authority in full, unless the agreement provides for the appointment of an overseer with full access to the debtor's books, accounts and records until the debtor has fully discharged its obligations under the agreement. In addition, the agreement may provide for the establishment of a creditors' committee, which will have the powers and authority set out in the agreement.

#### **4.3 The initiation of an informal corporate rescue process?**

The Bankruptcy Law refers to informal work-outs and restructuring (non-judicial reorganisations) as out-of-court agreements that may be entered into prior to adjudication between the debtor and its creditors in order to provide for debt relief and restrictions on the debtor's management and disposition powers. In that sense, an out-of-court agreement providing for an informal work-out can affect the management of the debtor but not substitute it (eg, with a creditors' committee) because the Corporation Law prohibits a board and its individual members from delegating their functions and duties. However, the out-of-court agreement may provide for all kinds of limitation and restriction on the management powers of the debtor's board and officers.

### **5. Parties in interest/key players**

#### **5.1 Who is responsible for the 'case management control and administration of a corporate bankruptcy/liquidation, a formal rescue and an informal rescue?**

##### **(a) Corporate bankruptcy/liquidation**

In this situation the control and administration of the process are vested in a receiver. Initially the court appoints a provisional receiver (and a deputy), as selected by the largest creditor from the national list of eligible receivers. At the first creditors' meeting the majority of the creditors with proven claims may ratify these appointments or appoint a new receiver and deputy, also from the national list of receivers. In performing his or her functions the receiver is subject to the control and supervision of the Bankruptcy Commission.

Receivers are generally charged with the authority to represent the interests of the creditors and the debtor in the administration of the bankruptcy/liquidation, whether in court or in any

other transactions or matters relating to the estate. The receiver may:

- access and review all information, accounts and records of the debtor;
- make proposals regarding key issues (eg, the court-determined date of default), with the approval of the majority of the creditors and the debtor;
- maintain the continuity of the business of the debtor and carry out its sale as an economic unit pursuant to the approved terms and conditions;
- collect all estate claims;
- run the proof of claims process; and
- sell the estate assets and distribute the proceeds to the creditors in accordance with the applicable priority rules.

#### **(b) Formal rescue**

In a formal rescue the officer responsible for 'case management' control varies according to one of three situations.

**Bankruptcy pre-emption process:** Until an agreement is finally approved, the debtor will be under the control of a receiver, but acting in the more limited capacity of an overseer. Among other things, the designated officer shall inform the bankruptcy court if the proposed agreement is feasible given:

- the circumstances of the debtor;
- whether its performance will leave the debtor better off than liquidation; and
- the likely amount to be recovered by unsecured creditors.

In addition, the receiver will be in charge of the proof of claims process to determine the number and identity of legitimate creditors and their claims with a right to vote. If the creditors fail to approve a stay order, the receiver must carry on with the realisation of the assets and approve any disposition or encumbrance of estate assets.

**Creditors' meeting:** If the debtor elects to ask the court to call for a creditors' meeting to designate an expert facilitator to oversee the submission of an agreement proposal, the court shall do so and designate an overseer to manage and coordinate the proceedings until the appointment of the expert facilitator. Following the appointment of the expert facilitator and until his or her proposed agreement is either approved or rejected, the process will be managed by the expert facilitator.

**Bankruptcy release process:** If the bankruptcy has already been adjudicated and the debtor or any of its creditors initiates a bankruptcy release process, the debtor will continue to be subject to the receiver as provided for above until an agreement is approved.

#### **(c) Informal rescue**

In the case of an out-of-court agreement or informal rescue, there are no specific rules. The debtor and the signing creditors may agree on the appointment of an overseer or the establishment of a creditors' committee with such functions and powers as the parties to the agreement may agree on, in order to oversee and control the management of the debtor pending completion of the agreement and to ensure compliance with its terms.

### **5.2 Who is responsible for preparing the restructuring plan in a formal or informal rescue?**

#### **(a) Formal rescue**

In general, a restructuring must form part of an agreement in a formal rescue process. To be valid and binding on the debtor and all its unsecured creditors, including dissenting minorities, the agreement must be approved by the debtor and not less than two-thirds of all individual creditors representing no less than three-quarters of the claims. Therefore, the plan contained in the proposed agreement must be negotiated with unsecured creditors only. Secured creditors vote only if they become unsecured by relinquishing their security status. The applicable legal provisions do not allow for different classes of creditor for voting purposes. This is particularly relevant in a context where most financial corporate credit is secured.

In order to determine the parties responsible for preparing the restructuring plan, three different situations may arise:

- the bankruptcy pre-emption process, where the debtor prepares and submits a plan;
- designation of an expert facilitator, who prepares and submits the plan; or
- a bankruptcy adjudication, in which the debtor or any of its creditors may seek a bankruptcy release process, in which case whomever sought the release must prepare and submit the relevant plan.

**(b) Informal rescue**

There are no specific rules in regard to out-of-court agreements to approve informal rescues. The debtor and one or more of its creditors are free to negotiate and adopt whatever system they see fit to handle the case management, control and administration of the informal rescue in the out-of-court agreement, bearing in mind that such agreement will be binding and enforceable only upon them.

**5.3 Who are the key players? What are their roles and responsibilities?**

**The courts:** Chilean legislation does not provide for judges specialised in commercial or insolvency cases. Hence, courts of general civil and commercial jurisdiction deal with insolvency and bankruptcy cases. Their role is to oversee, conduct and adjudicate any issues that are raised during the process, such as challenges to the validity of a claim or the appointment or removal of a receiver.

**Receivers:** Court-appointed receivers usually play a key role. They are generally experienced at coping with the complexities and specific demands of these processes. They are fundamentally in charge of:

- managing the case;
- collecting estate claims;
- selling estate assets;
- paying estate expenses; and
- conducting the proof of claims process.

**Expert facilitator:** This is a third party selected by the debtor and approved by a majority of all claims (including secured claims). He or she is responsible for examining and assessing the legal, financial and operational condition of the debtor and, on that basis, preparing an agreement proposal containing terms and conditions that offer better prospects than the liquidation of the debtor or, alternatively, requesting court adjudication.

**Overseer:** The overseer is an officer in charge of overseeing the affairs and management of a party seeking a formal rescue with full access to its information, accounts and records, and more or less limited power to control and authorise the management and disposition by the debtor of its assets and property.

**Creditors:** The law does not provide for creditors' committees, but creditors' interests are reasonably

safeguarded by creditors' meetings that enable creditors to participate actively in the insolvency process and to monitor the process to ensure fairness and integrity. In every bankruptcy process the first creditors' meeting has to ratify or designate a new receiver and a deputy, and adopt a number of key decisions and actions to set out the main variables of the ensuing proceedings. There are regular (or scheduled) and extraordinary meetings, the latter being held as and when circumstances require.

**Bankruptcy Commission:** The Bankruptcy Commission is an independent regulatory and supervisory institution in charge of overseeing bankruptcy proceedings. It supervises and controls the activities of receivers in all technical, legal and financial aspects of their receivership, and is subject to the supervision of the General Comptroller's Office solely with regard to the examination of its income and expense accounts.

**Debtor:** Although in a bankruptcy scenario the management and corporate powers of the debtor are handed over to the receiver, the board continues to represent the company in all decisions that do not pertain to the property within the bankruptcy estate. Accordingly, such key decisions as the approval of an agreement or the disposition of property other than through a judicial auction sale will require the consent of the company, and therefore of its board and/or its shareholders.

**6. What financial information is available to creditors?**

The Bankruptcy Law does not elaborate on this subject. A public (ie, listed) company will continue to be subject to continuing reporting and disclosure obligations on an ongoing basis during its bankruptcy. With respect to all other companies, in general the debtor has no specific obligation to provide information to its creditors (unless contractually required to do so under bond indentures or credit agreements). The law requires that all financial and other information of the debtor be made available to and handled by the receiver, who is obligated to report and give its account to the creditors at the monthly scheduled creditors' meeting throughout the entire process.

Creditors representing 10 per cent of the claims may require that the receiver designate an independent auditor.

In the case of both formal and informal rescues,

the agreement may establish provisions imposing certain information reporting and access requirements on the company.

## 7. Common questions

### 7.1 Funding and the priority given to new money

Other than bankruptcy expenses, the Bankruptcy Law does not contemplate a commercially sound form of priority for ongoing business needs during the reorganisation (eg, the use of available cash as collateral for raising bank credit or the creation of other security to obtain new funding with assurances and safeguards for the eventual repayment of this funding). According to the Bankruptcy Law, after the adjudication, the receiver may seek the continuation of the business of the debtor, but only for a one-year period (renewable once). During that time the receiver may seek new funding and lenders shall have recourse only against designated assets comprised in the continuation, but excluding the assets previously mortgaged or pledged (unless otherwise consented by the secured creditors). Subject to those exclusions, the claims of providers of new funding shall have priority over other unsecured creditors.

Since the exclusions typically constitute the majority if not all the remaining assets of the debtor in reorganisation and as Chile has usury laws that generally prevent charging of the normally high interest rates that would compensate for the added risk assumed by a lender who provides funding for the ongoing business needs of a debtor in reorganisation, in practice no lenders will be willing to provide such new money or debtor-in-possession financing.

### 7.2 Ranking of creditors

#### ***In what order are creditors paid in a corporate bankruptcy/liquidation?***

The receiver must apply the funds available to pay the creditors in accordance with the applicable statutory priorities according to the five categories of claim specifically listed in the Civil Code. However, creditors in the fifth category can subordinate their claims and thus become junior to all other unsecured creditors in case of a general subordination, or to specific unsecured creditors in case of a limited or restricted subordination. No other claims will be given recognition in Chile, nor will any priority in any other jurisdiction be

recognised in Chile. Accordingly, in a corporate bankruptcy/liquidation the receiver shall make payments in the following order of preference:

- Category one –
  - judicial costs incurred in the general interest of creditors;
  - expenses incurred in connection with the recovery of assets of the debtor, bankruptcy administration expenses, expenses incurred in the disposition of estate assets and loans raised by the receiver to fund the above-specified expenses;
  - employee salaries;
  - employee social security payments;
  - employee severance payments (capped); and
  - government claims for withholding and surcharge taxes;
- Category two – claims secured with a pledge lien, a contractor's lien on works or a transporter's lien on cargo;
- Category three – claims secured with a mortgage lien;
- Category four – sundry claims generally irrelevant in a corporate bankruptcy/liquidation; and
- Category five – all other claims that do not enjoy a statutory preference or a security interest over assets of the bankrupt corporation.

### 7.3 Avoidance of antecedent transactions

#### ***Are there any legal provisions that might operate to invalidate the creation of security, the disposal of an asset or the payment of a creditor by a company in financial difficulties?***

In a corporate bankruptcy/liquidation the adjudication has certain retrospective effects, including on the ability of the receiver or the creditors to challenge certain transactions entered into between the court-determined date of default and the date of the adjudication. The court-determined date of default is proposed by the receiver and approved by the court, and may be up to two years before the date of the adjudication. During that look-back period, the following transactions shall be ineffective in regard to the bankruptcy estate:

- any anticipatory payment made by the debtor;
- any payment of a past due obligation that is not made in accordance with the original terms; and
- any security interests created to secure previously incurred obligations.

In addition, the receiver or any creditor may seek to have declared null or void other payments not included in the foregoing, or transactions for value, provided that the relevant payee or counterparty to such transaction for value knew at the time of the debtor's default. Similarly, set-offs can be declared void if the claims against the debtor were acquired in knowledge of its default. This provision has an exception when set-off comes from a derivative transaction (ie, swaps). A mortgage lien may be validly created up to the date of the adjudication, but will be avoidable if its registration takes more than 15 days from the date of the relevant mortgage deed.

#### **7.4 'Cram-downs'**

***What is the position of both unsecured and secured creditors that vote against, do not agree with or do not consent to either a formal or an informal rescue plan?***

**Formal rescue:** In the case of an approved formal rescue agreement, unsecured creditors that vote against, do not agree with or not consent to the plan are bound by it and remain unsecured. Secured creditors that vote to approve the agreement are bound by it and lose their secured status. In other words, secured creditors in a formal rescue process have the right to keep their priority and the right to enforce their claims in accordance with their respective terms regardless of the approval of an agreement, provided that they do not participate in the vote and exclude themselves from the creditors eligible to vote and form a majority to approve or reject the proposed agreement.

**Informal rescue:** In the case of an executed out-of-

court agreement, there is no voting procedure and only those creditors that enter into the agreement are bound by the terms thereof.

#### **7.5 Creditor protection**

***What action can creditors take if they are not satisfied with the conduct of either a formal rescue procedure or a corporate bankruptcy/liquidation?***

In a formal rescue procedure the creditors may seek the adoption of a more stringent intervention on the company by the appointed receiver or overseer if the debtor's business or financial conditions deteriorate so as to potentially prejudice the interests of the creditors. A majority of claims is necessary to trigger these measures. Similarly, a majority of claims is necessary to seek the early termination of the approved agreement based on the same cause. Furthermore, any creditor is allowed to seek a termination of the approved agreement if the company defaults in the performance of its obligations. If the court orders the early termination of the approved agreement, the court must either reinstate the bankruptcy/liquidation process or adjudicate the bankruptcy.

In a corporate bankruptcy/liquidation, if the creditors are not satisfied with the receiver's conduct, they can remove it with the affirmative vote of a majority of the claims in a duly convened extraordinary creditors' meeting summoned by not less than one-quarter of such claims. In addition, creditors may seek damages in a summary action before the bankruptcy court in case the creditors reject the definitive account rendered by the receiver.